United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL

75-7546

United States Court of Appeals

For the Second Circuit

OSCAR GRUSS,

Plaintiff-Appellee,

and

OSCAR GRUSS & SON,

Plaintiff,

—against—

THE CURTIS PUBLISHING COMPANY,

Defendant-Appellant.

APPELLEE'S BRIEF

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2

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

A. Cases — Page

Cases

B. Statutes and Rules

C. Treatises

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

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OSCAR GRUSS, Plaintiff-Appellee, and OSCAR GRUSS & SON, Plaintiff, -against- THE CURTIS PUBLISHING COMPANY, Defendant-Appellant.	:	Docket No. 75-7546

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APPELLEE'S BRIEF

ISSUES

1. When a state statute requires that in order to exercise dissenting shareholders' rights of appraisal, letters of objection must be filed by registered owners of the shares, and not by the beneficial owners, does proxy material which states merely that such letters must be filed by "holders of shares", without indicating that the shareholders must be the registered owners, violate Section 14(a) of the Securities Exchange Act of 1934 (the "Act") and the rules and regulations promulgated thereunder?

The court below answered in the affirmative, and appellee agrees.

2. When a state statute defines "shareholder" as a "registered owner of shares", and when proxy material purporting to set forth all statutory provisions pertinent to exercising rights of appraisal wholly omits such definition and wholly omits to indicate, in any other manner, that in order to exercise appraisal rights certain state procedures must be followed by the registered owner, rather than the beneficial owner, has the company which disseminates such proxy material violated Section 14(a) of the Act and the rules and regulations promulgated thereunder?

The court below answered in the affirmative and appellee agrees.

3. Is scienter required for liability under Section 14(a) of the Act when proxy material fails to provide specific information required by a regulation promulgated thereunder?

The court below answered in the negative and appellee agrees.

4. Is a failure to advise beneficial owners of securities that they must exercise their appraisal rights through the registered owners of their shares, a material omission within the meaning of Sction 14(a) of the Act and the rules and regulations promulgated thereunder?

The court below answered in the affirmative and appellee agrees.

5. Was the finding of the trial court, that plaintiffs were not contributorily negligent, so unsupported by the evidence as to be clearly erroneous?

The court below answered in the negative and appellee agrees.

6. Is contributory negligence a defense to a violation of Section 14(a) of the Act and the rules and regulations promulgated thereunder?

Since the court found there was no contributory negligence, it was not required to and did not reach this issue. Appellee would answer in the negative.

7. Did the trial court fail to utilize the appropriate criteria in valuing securities for appraisal purposes?

The court below answered in the negative and appellee agrees.

8. Was the finding by the trial court, as to the value of the securities in question, both (a) clearly erroneous on the basis of the evidence and (b) impermissable in the exercise of reasonable discretion?

The court below answered in the negative and appellee agrees.

STATEMENT OF THE CASE

A. GENERAL STATEMENT

This is an action based upon defendant's violation of Section 14(a) of the Securities Exchange Act of 1934 (the "Act") and the Rules and Regulations promulgated thereunder. It arose because defendant refused to recognize plaintiffs' rights of appraisal under the Pennsylvania Corporation Law ("PCL") as dissenting shareholders upon a recapitalization with respect to 12,560 shares of defendant's $4 dividend prior preferred stock (the "Preferred Stock") (29a - 30a)*. Defendant's refusal was based on its contention that the plaintiffs had not followed the procedure required by Section 515 of the PCL because a letter attempting to exercise such rights was signed by the beneficial holder, plaintiff Oscar Gruss ("Gruss"), rather than by the record holder, plaintiff Oscar Gruss & Son ("Gruss & Son"), as required by the statute.

The court below held that the proxy material distributed by defendant was misleading in failing to specify that the PCL required that the registered owner, and not the beneficial holder of shares, exercise appraisal rights; that Gruss, the beneficial owner, rather than Gruss & Son, the record owner, attempted to exercise such rights because of such misleading proxy material; and that such breach of duty on the part of defendant constituted a violation of Section 14 of the Act and the rules and regulations promulgated thereuner (267a - 268a, 262a). It held that Gruss was entitled to recover damages against defendant in the amount which he would have been entitled to receive upon a proper exercise of his appraisal rights. In determining the amount of Gruss' damages, the court valued the Preferred Stock owned by Gruss as of the day immediately before the effective date of the recapitalization without giving effect to any change in the value caused by the Plan

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* References are to pages of the appendix.

of Recapitalization, all as required by Section 515 of the PCL (271a). It decided that such value was $188,400 and accordingly awarded judgment in favor of Gruss in that amount together with interest and certain costs (284a).

The defendant moved for an amendment of the court's findings and conclusions and for a new trial (the "Reargument Motion") submitting affidavits from its officers and Pennsylvania counsel, without any explanation as to why there was no testimony at the trial as to the matters set forth in the affidavits (287a - 304a). The court below granted reargument but adhered to its original decision. It issued supplemental findings stating that defendant's contentions, as set forth in its motion papers, were erroneous and that no basis existed for receiving additional testimony from defendant since no justification was made for failing to provide such testimony at the trial (312a - 315a).

B. FACTS PERTAINING TO THE ISSUE OF LIABILITY UNDER THE ACT.

The following uncontroverted facts appear from stipulations or the evidence introduced at the trial.

Gruss & Son is a co-partnership engaged in the securities business. Gruss is a general partner of Gruss & Son and the beneficial owner of the Preferred Stock which is registered in the name of Gruss & Son (29a, 43a - 44a).

Pursuant to a vote of shareholders, at a meeting held on September 14, 1972, the defendant effected a plan of recapitalization under which holders of its Preferred Stock were required to exchange their shares for shares of common stock. The proxy material which was distributed in connection with the shareholders' meeting described the plan and purported to set forth the procedure pursuant to which a dissenting shareholder could exercise his rights of appraisal under the PCL (29a, 326a - 329a, 366a). It stated that under Section 515 of the PCL, in order to

exercise such rights, "holders of shares" were required to file a written objection to the plan before the meeting. However, it omitted to state that Section 2(18) of the PCL defined the word "shareholder" as the "registered owner of the shares" so that the written objection had to be filed by a registered shareholder and not a beneficial shareholder. Moreover, the proxy materials, while containing, as an exhibit, the exact language of Section 515 of the PCL, did not state, paraphrase or even mention Section 2(18), the section defining the meaning of the term "shareholder (366a - 407a). Therefore, from a reading of the proxy materials a beneficial holder of shares would have no way of knowing that he could not exercise his appraisal rights by filing a written objection and that he was required to cause a registered holder to file it in his behalf.

Julius Anreder ("Anreder"), the director of Securities Research at Gruss & Son, was directed by Gruss to take whatever steps were necessary to object to the plan of recapitalization and exercise his rights of appraisal (49a, 67a). Anreder then studied the procedure outlined in the proxy material for exercising appraisal rights and attempted to follow it on a "step by step" basis (76a - 77a, 84a). He prepared a letter objecting to the plan of recapitalization for the signature of Gruss (85a - 86a). He testified that he prepared such letter for the signature of the beneficial owner, rather than the signature of the registered owner, because the proxy material did not require that the letter be signed by the record holder and not the benefical owner (94a). The letter of objection prepared by Anreder was delivered to Gruss for execution on September 12, 1972 (49a) and was signed by Gruss (32a, 48a, 75a - 76a), mailed by Anreder together with a proxy voting against the recapitalization (46a - 47a, 48a - 49a, 75a - 76a, 90 - 91a) and received by defendant prior to the shareholders' meeting (29a - 30a, 44a -

45a, 46a - 47a, 49a, 55a - 56a).

Although the defendant had previously obtained a document purporting to be a proxy from Gruss & Son in favor of the recapitalization in August, 1972 (45a - 46a), the subsequent September proxy mailed by Anreder voting against the recapitalization, together with the letter of objection, revoked any prior proxy in favor of the plan. Moreover, Gruss testified that no one was authorized to deliver a proxy in favor of the plan (59a - 61a). On this appeal, the defendant does not appear to take issue with the finding by the court below that the proxy mailed by Anreder revoked any prior proxy in favor of the plan.

On the Reargument Motion, the plaintiffs submitted three affidavits containing statements which were not only irrelevant, but could have been provided through testimony at the trial. One of the affidavits was from the Secretary of the defendant. It states that the corporate records indicated that there were two other dissenting shareholders whose stock was held in street name, but that the letters of objections were signed by the registered owners (293a - 295a). Another affidavit was submitted by the President of the defendant. It states that Anreder had said that, if he were elected a director of defendant, he would recommend an approval of the plan of recapitalization (301a - 302a). The third affidavit was submitted by a member of the firm of Morgan, Lewis & Bockius, the attorneys who prepared the proxy material. It states that the appraisal section was in the same form as that utilized by said firm and other Pennsylvania firms in other proxy statements previously prepared by them (303a - 304a).

In opposition to the Reargument Motion, Anreder submitted an affidavit which categorically denied that he ever advised defendant's President that he would recommend the recapitalization only if he were made a board member (305a - 306a). He stated that Gruss' reasons for objecting to the plan had nothing to

do with whether or not Anreder was made a director but were based upon the fact that the recapitalization was inequitable to the holders of the Preferred Stock (306a - 307a). In any event, he pointed out, the reasons for plaintiffs' dissent were irrelevant (306a).

C. FACTS PERTAINING TO THE DAMAGES INCURRED AS A RESULT OF DEFENDANT'S VIOLATION OF THE PROXY RULES.

In determining the amount of damages incurred by reason of defendant's violation, the court heard the testimony of an expert witness for each of the parties as to the fair value of the preferred stock, as at September 13, 1972, the day before the recapitalization (the "valuation day"). Under the statute, dissenting shareholders are entitled to the fair value of their securities at the valuation day, without regard to appreciation or depreciation resulting from the recapitalization giving rise to the appraisal rights

1. The Testimony of Plaintiffs' Expert Witness.

The plaintiffs' expert, Julius Anreder, not only had the qualifications of an expert witness*, but he had the additional insight obtained from closely following the business and financial affairs of defendant over the years, as the analyst for one of its major shareholders, Gruss & Son (107a - 108a). Thus, in valuing the securities in question, he was able to draw on his prolonged analysis of the company and communications with its officers over the years, as well as information current at the time of the trial (248a - 250a).

Mr. Anreder testified that he reached an opinion as to the fair value of the Preferred Stock on the valuation day by considering the following factors:

* See 107a - 109a for Mr. Anreder's qualifications including, inter alia, that he is a Chartered Financial Analyst and a member of the New York Society of Security Analysts.

(i) The market value of the Preferred Stock on the valuation day (118a, 153a);

(ii) The market price of the common stock on the valuation day (123a - 124a, 117a);

(iii) The accrued dividends on the Preferred Stock at the time of the valuation day, which were $30.75 per share (153a - 154a, 120a).

(iv) The market value of the Preferred Stock during the previous 18 months (118a, 154a);

(v) The market value of defendant's other class of prior preferred stock, the $1.60 preferred, at the valuation day and historically, in view of the fact that the $1.60 preferred and the Prior Preferred had, proportionately, the same rights and privileges (155a);

(vi) The number of shares of both classes of preferred stock, which were outstanding, i.e., 334,470 shares of the Prior Preferred and 239,418 shares of the $1.60 preferred (155a);

(vii) The rights of each class of preferred stock, i.e., the holders of Preferred Stock were entitled to receive $3.00 per annum in dividends plus $1.00 contingent dividend, and the holders of $1.60 preferred stock were entitled to receive a $1.60 per annum dividend plus a $1.00 contingent dividend. All such dividend rights were cumulative. Because of non-payments of such dividends, the accrued dividends payable on the Preferred Stock and the $1.60 preferred stock were $30.75 and $6.00 respectively. All dividend arrearages had to be paid in full before the common stockholders could receive anything. In addition, the liquidation value of the Preferred Stock and $1.60 preferred stock was $65 and $25 respectively plus accrued dividends (155a - 156a, 364a - 365a, 109a).

(viii) The rights and preferences of defendant's other securities (118a, 155a);

(ix) The net asset value and financial statements of the defendant (157a);

(x) The fact that the defendant had reintroduced the Saturday Evening Post in 1971 which had been carried from a "start up" expense loss to a "break even" situation in the first quarter of 1972 (156a - 157a);

(xi) The turn around and the profit picture of defendant in the first quarter of 1972 (after three prior years of losses) (156a - 157a);

(xii) The fact that the balance sheet showed that the current assets and current liabilities of defendant were approximately equal; that the company had no major liability except for income bonds; and that no principal payments were required to be made by the Company to the bondholders until 1986 (157a, 109a - 110a, Page 38 of Plaintiff's Trial Ex. 7);

(xiii) The fact that the proxy statement said that there were several alternatives open to management, other than an immediate reorganization, including continuing to operate the defendant company as it was (158a, 326a);

(xiv) The inability of the public to understand preferred stock, thus causing an inordinately low market value of defendant's Preferred Stock (117a);

(xv) Mining reports issued showing that the company's mineral rights in land located in Timmins, Ontario, were worth between $2 million and $6.5 million (127a - 128a, 158a et seq.); and

(xvi) The fact that definite progress had been made under the leadership of Burt Ser Vaas, the new president of defendant, in terms of eliminating or settling substantial tax liabilities and certain substantial litigation, and putting the balance sheet in order (162a).

Mr. Anreder also testified that in arriving at his valuation, he considered the material in the proxy statement (introduced into evidence as plaintiffs' Exhibit 2) and said:

> "I read it through quite thoroughly. I studied it, I analyzed it, and I appraised various factors in it and appraised the information which was included in it." (109a)

He testified in like manner concerning his analysis of the material in the exchange offer prospectus to debentureholders (introduced into evidence as plaintiffs' Exhibit 7) (109a - 110a).

From the proxy statement, it appears that various unprofitable operations had been sold or otherwise disposed of by the end of 1971 (355a - 356a). From the exchange offer prospectus, it appears that income debentures which had been issued did not have to be paid by defendant until October 1, 1986.

The proxy statement also shows that, prior to the recapitalization, 20% of the common stock was held by Mr. Ser Vaas (363a) who had bargained for the issuance to him of those shares in consideration of his agreement to manage the affairs of the company (333a, 208a). Certainly Mr. Ser Vaas would not have attached importance to such common stock, which could not receive anything until all arrearages on the Preferred Stock were paid, unless the Preferred Stock had substantial value.

On the basis of the factors he considered, Mr. Anreder stated that the company definitely had the ability to remain an ongoing concern, without recapitalizing in any manner (130a - 131a, 157a - 158a). Moreover, Mr. Ser Vaas, the company's president, apparently agreed because he had admitted as much to Mr. Anreder at a prior conversation (253a).

Mr. Anreder also recognized that preferred stock, as involved in the instant action, must be valued differently, in some respects, than common stock.

He testified that market value in this case did not properly reflect the fair value of the Preferred Stock because:

> "...[T]he investment public, especially in companies that have had financial difficulties, doesn't really understand the senior securities and the rights and preferences to which they are entitled, and, as a result, the market price of those securities is not really indicative of what their value should be." (117a)

In addition, he testified that, because the instant case related to valuation of preferred stock, rather than common stock, the cumulative dividend rights and liquidation preference were highly relevant in determining value, especially because the evidence clearly supported a finding that the company could continue in business indefinitely without any recapitalization (155a - 156a).

Based upon all the factors considered, Mr. Anreder testified that he concluded that the value of the Preferred Stock was $15 per share, or $188,400 for the 12,560 shares owned by the plaintiffs (175a).

Mr. Anreder also arrived at a fair value of the Preferred Stock by determining the overall worth of the company from the market value of its common stock*, and then determining the percentage of such worth allocable to the Preferred Stock in view of the other securities then outstanding, i.e., by utilizing a fictional but fair recapitalization as a tool for determining the value of the preferred stock in relation to the company's worth. On the basis of his recapitalization, Mr. Anreder testified that each share of the Preferred Stock was worth 5.23 common shares. (After a reverse one for ten split hypothesized by Mr. Anreder - see Mr. Anreder's explanation of such recapitalization.) Utilizing the market price of the common stock on the valuation date, and the factor of 5.23 shares of the common for each share of the Preferred Stock, Mr. Anreder reasoned that the fair value of the Preferred Stock was approximately $16.34 per share or $205,230.40 for the 12,560 shares owned by plaintiffs (176a - 181a).

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* Mr. Anreder testified that the market value of the common stock was the only indicator of the company's speculative worth because preferred stock was not fully understood by the public.

2. <u>The Testimony of Defendant's Expert Witness, Fred Shinagel.</u>

In reaching his opinion, Mr. Shinagel examined only the proxy statement delivered to the shareholders, the annual report and the trading records for the company's common and preferred stock for the year 1974 (200a). Based upon (i) the above mentioned documents, (ii) a misconception on his part that management believed that the company had to be recapitalized in order to survive, and (iii) his testimony that the proxy material showed that the company had earnings in only one of the previous ten years, Mr. Shinagel testified that the company only had speculative value which was between $1 million and $2 million dollars (207a).

After concluding that the company had a total value of only $1 million to $2 million, Mr. Shinagel utilized a fictional recapitalization in order to determine the value of the Preferred Stock in light of the value of the other outstanding securities. However, unlike Mr. Anreder (who utilized a fictional recapitalization as one of two bases for determining value), Mr. Shinagel initially sought to utilize the defendant's actual plan of recapitalization, i.e., the very plan objected to by plaintiffs as being unfair and inequitable, rather than a recapitalization which in his independent, studied, expert opinion would properly reflect the relative rights among the different securities holders (209a - 210a). There is no evidence that defendant's plan was proper; not even Mr. Shinagel so testified. The court did not permit Mr. Shinagel to proceed with his valuation based on the company's plan of recapitalization (210a - 211a).

Mr. Shinagel then purported to offer his spur of the moment opinion as to a fair, independent recapitalization for the purpose of valuing preferred stock in light of the alleged total worth of the company. In doing so, he attributed one-quarter of the company's net worth to the common stock and three-quarters

of the company's net worth to the preferred shareholders, allocating 50% of such three-quarter portion to each of the two classes of preferred stock (211a). In accordance with Mr. Shinagel's recapitalization, and his estimate of the company's net worth, he testified that the fair value of the Preferred Stock amounted to $1.50 per share or $18,840 for the 12,560 shares owned by the plaintiffs (214a - 215a). It should be noted, however, that utilizing Mr. Shinagel's recapitalization, the calculation of the fair value of $1.60 preferred stock amounts to a $1.04 per share, i.e., only 56 cents per share less than the $4.00 preferred (the Preferred Stock owned by plaintiffs) even though the dividend, cumulative dividend and redemption rights of the $4.00 preferred were, respectively 200%, 500% and 400% greater than that of the $1.60 preferred. It is evident, therefore, that Mr. Shinagel's spur of the moment recapitalization, upon which his valuation was based, had no validity in logic or fact.

Mr. Shinagel also purported to analyze the fair value of the Preferred Stock from a study of market prices and activity. He noted that Preferred Stock trading was more active just prior to the recapitalization than common stock trading, erroneously assumed that the greater activity of the preferred trading rendered its market value a true indication of its speculative worth, and thereby concluded that the market value of the Preferred Stock (rather than the market value of the common stock) was the true indicator of value (221a - 222a). Based upon such assumption, Mr. Shinagel testified that the value of the Preferred Stock was $1.50 per share (223a). It is interesting to note that such figure is identical to that arrived at by him in utilizing his fictional recapitalization.

Cross examination of Mr. Shinagel revealed that his assumption that the company could not continue to exist without a recapitalization was invalid. Since Mr. Shinagel had admitted that his valuation would have been higher if the company had been able to continue without a recapitalization (226a), the fallacy

of such assumption discredits his entire testimony.

He testified on cross examination that his assumption that a recapitalization was necessary was based upon (i) a portion of the prospectus stating that the company's operations would not support its dividend burdens without the recapitalization (226a), and (ii) financial statements indicating that the company could not meet its cash flow requirements (227a - 228). However, he did acknowledge that the very next statement in the prospectus stated that alternatives to the recapitalization existed, including a continuance of operations (231a). Moreover, Mr. Shinagel admitted that, from an examination of such financial statements, he could not state that the company would not be able to raise further capital in order to enter additional business ventures and/or meet its cash flow requirements (227a - 228a).

On continuing cross examination, Mr. Shinagel also admitted that the recapitalization was voluntary and that bankruptcy was not in any way contemplated or required (232a - 233a).

In rebuttal, Mr. Anreder testified that Mr. Ser Vaas, the defendant's president, had admitted the recapitalization was not necessary to continue the company's operations (253a). Indeed, as shown on ~~pages~~ page 42 hereof, an examination of the March 31, 1972 balance sheet (371a) reveals that \$13,000,000 of the company's \$16,000,000 shown as liabilities were not payable until 1986.

Mr. Shinagel attempted to restore the validity of his opinion by contending that the company had no means to raise additional capital unless Mr. Ser Vaas was personally involved in the company's affairs (228a) and that the proxy material stated that "credit has not been available to the company for some time". However, he conceded that Mr. Ser Vaas was the president, had a substantial interest in the company, that he would be likely to remain involved in his quest for additional funds and business (228a - 229a), and that the statement in the proxy referred to the availability of credit in the past and did not refer to the availability of credit as a result of management changes in the company (230a). Indeed, since prior to the recapitalization, Mr. Ser Vaas had purchased and received 20% of the company's common stock in consideration of his agreement to manage its operations, and since holders of common stock were not entitled to receive anything until arrearages on the Preferred Stock were paid in full, Mr. Ser Vaas would have had more than a substantial interest in seeing to it that the Preferred Stockholders were paid (333a).

With respect to his opinion that the greater market activity in the Preferred Stock rendered its market value a more accurate indicator of its fair value, Mr. Shinagel, on further cross examination, admitted that such activity might have been the result of the forthcoming recapitalization. He testified that if such plan of recapitalization was unfair to the Preferred Stockholders, they would desire to sell before the effective date thus causing significant market activity and lower prices (237a). In fact, he testified that in June of 1972, immediately before the proxy material was publicly disseminated, the market value of the Preferred Stock was $4.65 per share (221a).

Mr. Shinagel compounded the errors of his analysis of value, based on market conditions, by considering the depressing effect on the market of a sale of all 12,560 of plaintiffs' shares would have (223a). Clearly, however,

this is an improper consideration since, in determining fair value for appraisal purposes, an investor is not placed in a position where he must dump his securities on the market.

3. The Court's Findings as to the Value of the Preferred Stock.

The court rejected Mr. Anreder's valuation method based upon a hypothetical recapitalization (274a), but found his testimony as to the value of the Preferred Stock credible, based upon his consideration of the pertinent factors (282a, 314a - 315a). It analyzed such testimony noting, inter alia, that Mr. Anreder had testified as to the reintroduction of the Saturday Evening Post which had reached a break even point in the first quarter of 1972 (275a); that he considered the progress made under the new management of Mr. Ser Vaas (276a); that Mr. Ser Vaas had expressed the opinion that "the company is not now losing money and that he could keep it going indefinitely" (276a); and that the company's appraiser had valued the company's Timmins mining rights at a minimum figure of $2 million (276a). From the evidence, the court agreed with Mr. Anreder that "the company was 'not in a position of having the wolf at the door'...that they could keep the company...going" (275a). The court then analyzed the testimony of the defendant's expert and noted, inter alia, that he considered the book value of the common shares, that he regarded the company as insolvent, and that he gave consideration to the market value of the company's securities (277a). It also noted that, despite Mr. Shinagel's conclusion that the value of the Preferred Stock was $1.50 per share, he had testified that before the proxy material was available or the plan known, the market value of the Preferred Stock was $4.75 per share (279a).

The court then made it clear that it was mindful of the three factors which are to be considered in valuing securities. It cited 79 Harvard Law Review

1456-57, Valuation of Dissenter's Stock (1966); and 15 Fletcher Cyclopedia Corporations, 1973 Revised Vol., Section 7165.4 p. 294, quoting therefrom to the effect that courts are to consider (i) net asset value, (ii) market value and (iii) investment or earning value in appraising securities (280a).

Turning to the factual evidence before it, the court weighed the credibility of the two expert witnesses. In doing so, it found that the testimony of the defendant's expert, as to the fair value of the Preferred Stock, was so low as to be "unfounded and unreasonable" (281a - 282a). On the other hand, it found that the testimony of the plaintiff's expert, including his conclusion as to valuation, was reasonable and credible (282a, 314a - 315a). Thus, the court accepted Mr. Anreder's expert testimony as truthful, and decided the valuation issue in accordance therewith (284a, 314a).

After valuing the Preferred Stock by weighing the evidence as described above, the court again scrutinized the conclusion reached by Mr. Anreder, this time in a different manner, and found that the reasonableness of the conclusion withstood such additional scrutiny. It observed that the value of the Preferred Stock expressed by him, to wit, $15 per share, was only 25% of the present value of the maximum amount which the holders of the Preferred Stock could receive in 1986 if the company were liquidated and if all dividend arrearages were paid. Since, based on the evidence, it believed that the company could continue in existence and that the prospects for payment were not unreasonable, the court concluded that Mr. Anreder's figure was within reason (282a - 283a, 314a - 315a).

ARGUMENT

POINT I

THE DEFENDANT IS LIABLE TO PLAINTIFFS FOR ITS VIOLATION OF SECTION 14 OF THE ACT AND THE PROXY RULES AND REGULATIONS PROMULGATED THEREUNDER

A. The Provisions Of The Act And The Rules And Regulations Which Were Violated By The Defendant.

Section 14(a) of the Act sets forth the general prohibition against the solicitation of any proxy in contravention of the rules and regulations the SEC proscribes "in the public interest or for the protection of investors". The Act does not limit the SEC's rule making power to the promulgation of rules relating solely to the disclosure of information pertaining to the company and/or its management, but broadly empowers the SEC to promulgate rules designed "for the protection of investors".

Pursuant to the Act, the SEC promulgated a regulation which specifically and expressly requires that a proxy statement describe the rights of appraisal available to dissenting shareholders and the statutory procedure for exercising such rights. Specifically, Item 2 of Schedule 14A under Regulation 14A requires such disclosure in proxy statements, as follows:

> "Outline briefly the rights of appraisal or similar rights of dissenters with respect to any matter to be acted upon and indicate any statutory procedure required to be followed by dissenting security holders in order to perfect such rights. Where such rights may be exercised only within a limited time after the date of adoption of a proposal, the filing of a charter amendment or other similar act, state whether the person solicitated will be notified of such date.
>
> "Instruction. Indicate whether a security holder's failure to vote against a proposal will constitute a waiver of his appraisal or similar rights or whether a vote against the proposal will be deemed to satisfy any notice requirements under State Law with respect to appraisal rights. If the State Law is unclear, state what position will be taken in regard to these matters." (Emphasis Added.)

The term "security holder", as utilized in the above-quoted Item 2, includes both beneficial holders and record holders. Elsewhere in its rules and regulations, under Section 14(a) of the Act, the SEC has expressly distinguished between holders of record and beneficial owners when such a distinction is intended. For example, subparagraph (b) of Item 3 of Schedule 14B under Regulation 14(a) requires a participant to state in proxy material the amount of securities of the company which he owns "of record but not beneficially". Similarly, Regulation 240.14a-7(a)(1) refers to a statement of the approximate number of "of holders of record" as distinguished from "holders" mentioned subsequently in the same sentence. Moreover, it is clear that the proxy rules are intended to provide information to beneficial shareholders, as well as record holders, in view of the requirements of Regulation 14c-7 under the Act to assure that proxy materials will be forwarded by record holders to the beneficial owners.

Defendant's omission of the fact that the PCL required a beneficial shareholder to cause a registered holder to give a written objection to the plan of recapitalization in order for him to exercise appraisal rights, constituted an omission of material facts required to be furnished under Item 2 of Schedule A. As a result of such omission, a beneficial shareholder, like Gruss, could simply improperly file his objection and thereby lose his rights of appraisal. This, as the court below stated, is a "trap for the unwary". Having been responsible for such trap, by its omission in violation of the proxy rules, it is shocking that defendant should now seriously contend that it should not bear the responsibility.

The significance of the defendant's failure to explain that the term "holders of shares" was restricted in meaning to record holders, becomes even more apparent when it is realized that Pennsylvania legislature realized the necessity

for defining the term since it was so restricted. It thereupon enacted Section 2(18) of the PCL which defines the term "shareholder" as a "registered owner of shares". Defendant chose not to include a similar definition in his proxy materials nor to include a copy of Section 2(18). Nevertheless, it expected shareholders to have sufficient knowledge of the Pennsylvania Business Corporation Law to realize that the term excluded beneficial owners.

Finally, the existence of the defendant's violation is established beyond a question when Rules 14(a)-5(a) and 14(a)-9(a) of the Act are considered. The former requires that the "information included in the proxy statement shall be clearly presented" and the latter requires that no proxy statement shall contain "any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material facts, or which omit to state any material fact necessary in order to make the statements therein not false or misleading...". Clearly, the failure to apprise beneficial holders of the manner in which they were required to object to the plan of recapitalization in order to preserve their rights of appraisal under Pennsylvania Law, caused the proxy material to be not "clearly presented", and constituted the omission of "material facts", in violation of Rules 14(a)-5(a) and 14(a)-9(a).

B. The Defendant Is Liable To Plaintiffs For Its Violation Of The Proxy Rules.

It is now well established that a private party may sue for violations of the Act and/or for violations of SEC rules and regulations promulgated thereunder. J.I. Case Co. v. Borak, 377 U.S. 426 (1964); Colonial Realty Corp. v. Bache & Co., 358 F. 2d 178 (2nd Cir. 1966), cert. denied 385 U.S. 817, Gerstle v. Gamble-Skogmo, Inc., 478 F. 2d 1281 (2nd Cir. 1973).

Defendant's above described violations of the proxy rules caused Gruss to improperly object to the plan of recapitalization. Since Section 14(a) of the Act makes it unlawful to solicit proxies in violation of SEC regulations promulgated "for the protection of investors", defendant's breach of duty is actionable under the case law cited above.

C. None Of The Arguments Riased By The Defendant In Opposition To The Holding Of Liability Are Valid.

In its brief, the defendant has raised a number of arguments in an attempt to show that it is not liable for a violation of the proxy rules. However, none of these arguments are valid.

1. Scienter Is Not Required And The Court Did Not Base Its Findings Upon Such A Requirement.

Defendant erroneously contends there must be a finding that it acted with scienter, i.e., wilfully or with reckless disregard of plaintiffs' rights, in order to be held liable under Section 14(a) of the Act. In support of such contention, defendant relies upon the case of Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F. 2d 341 (2nd Cir. 1973), cert. denied, 414 U.S. 910 (1973), which holds that scienter is required for liability under Rules 10(b)-5 and 14(e) of the Act. However, those cases have nothing to do with violations involved in the instant action, i.e., violations of Rule 14(a) of the Act and the rules and regulations promulgated thereunder.

In Gerstle v. Gamble-Skogmo, Inc., 478 F. 2d 1281 (2nd Cir. 1973), the court held that scienter was not required for liability under Section 14(a) of the Act, although it was required for liability under Section 10(b). It explained the distinction as follows:

> "Although the language of Rule 14(a)-9(a) closely parallels that of Rule 10b-5, and neither says in so many words that scienter should be a requirement, one of the primary reasons that this court

> has held that this is required in a private action under Rule 10b-5, [citations], is a concern that without such requirement the rule might be invalid as exceeding the Commission's authority under Section 10(b) to regulate 'manipulative or disceptive devices.' [citations] In contrast, the scope of the rule making authority granted under Section 14(a) is broad, extending to all proxy regulation 'necessary or appropriate in the public interest or for the protection of investors' and not limited by any words connoting fraud or deception...A reading of Rule 14(a)-9 as imposing liability without scienter in a case like the present is completely compatible with the statutory scheme. (478 F. 2d at 1299)

Moreover, the court in Gerstle expressly referred to the Chris-Craft case, relied upon by the defendants, and noted that the holding therein that scienter was a required element of a Section 14(e) violation was entirely consistent with its holding that scienter was not required for a Section 14(a) violation, because Section 14(e) was the anti-fraud equivalent of Rule 10b-5 applied to tender offers. Gerstle supra, fn. 17 at page 1299. Since the violation in the instant action is of Section 14(a) and the regulations promulgated thereunder, as in Gerstle, and not of the anti-fraud provisions of Section 10(b) and 14(e), as in Chris-Craft, scienter is simply not required for liability.

Although the defendant concedes that the Gerstle case is widely cited for the proposition that scienter is not required as an element of a Section 14(a) violation, it contends that Gerstle does not necessarily exclude the application of a scienter standard, relying on the statement in the opinion, "...this does not mean that scienter should never be required in an action under Rule 14(a)-9..." (478 F. 2d at 1300). In the instant action, defendant argues, scienter should be required because the information omitted related to the procedure contained in a public statute available to all, rather than a "substantive investment decision". However, there is no basis for such distinction and Gerstle does not support it.

In Gerstle, the court explained that scienter might be required for Section 14(a) violations in certain unusual situations unrelated to what a company is required to do under the proxy rules. It stated that scienter might be required where an alleged violation was based upon "statements issued by corporations without legal obligations to do so", so as not to discourage the laudatory practice of having corporations provide even more complete disclosure to its shareholders than required under the securities acts. The court in Gerstle then went on to state that "such considerations do not apply to a proxy statement required by the proxy rules". Since the misleading statement in the instant action involved a matter expressly required under the proxy rules, i.e., a description of the procedure required to be followed by a dissenting shareholder to exercise appraisal rights, the Gerstle decision itself has expressly ruled out any consideration that scienter is an element of the violation. Similarly, in foot note 19, at page 1300 the court in Gerstle provided another example of where scienter might not be required wherein it was noted that misstatements made "in the hurly-burly of election contests" might be excusable if not made with scienter in view of the pressures involved. It noted, however, that statements would not be so excused "which defendant had ample time to prepare and revise". Since the statement contained in the proxy material as to the procedure to be followed for exercising appraisal rights was drafted well in advance, and was subject to the opportunity for revision, the necessity of scienter is again expressly precluded by Gerstle.

Another fallacy of defendant's contention that scienter should be required is that its violation did not involve a mere omission to set forth a public statute, as defendant would have the court believe. The proxy statement affirmatively purported to set forth the applicable statutory provisions in Exhibit C thereto (336a).

Yet the section of the PCL, which defined "shareholder" as including only registered holders, was omitted. Thus a shareholder would reasonably believe that the proxy statement contained all the available statutory information and would not consider looking elsewhere. Defendant's material omission was certainly as injurious as the omission of information pertaining to "substantive investment decisions". Furthermore, it should be reiterated that Item 2 of Schedule 4(a) imposes upon defendant the obligation of describing the "statutory procedure" to be followed by dissenting stockholders. It is not the obligation of stockholders to determine such procedure by themselves.

Finally, the defendant claims that the court below held that scienter was required for liability in that it cited the Chris-Craft Industries, Inc. case, supra, and Schlick v. Penn-Dixie Cement Corp., 507 F. 2d 374 (2nd Cir. 1974), cases involving the anti-fraud sections of the Act. However, the court below cited those cases only in support of its finding that the omission in question in this case was material, and in no way indicated that it was applying the scienter standard of culpability set forth in those cases to the instant action. Moreover, any illusion that the court below shares defendant's erroneous belief that scienter is an element of a 14(a) violation, is destroyed upon a glance at the first paragraph of the court's supplemental findings, in response to defendant's reargument motion, wherein it is expressly stated that scienter is not required for liability herein (312a).

2. The Omission Was Material.

Defendant contends that its failure to advise beneficial shareholders of the procedure to be followed by them under the PCL in order to exercise appraisal rights was not a material omission, as required for liability under the proxy rules. However, under all definitions of materiality defendant's omission was material.

In Mills v. Electric Auto Light Co., 396 U.S. 375, the Supreme Court stated that an omission or misrepresentation in a proxy statement is material if it "might" have been considered important by a reasonable shareholder. As pointed out by defendant, in Gerstle, supra, the court suggested that materiality requires that the omission or misrepresentation "would" have been considered important by a reasonable shareholder. However, in the instant action, any reasonable dissenting beneficial shareholder clearly would have caused the registered holder to object if the proxy statement had stated that this was required. Thus, whether the test for materiality requires that the reasonable shareholder "might" have been misled or "would" have been misled, defendant's omission in the instant action was material.

The comments in the defendant's brief to the effect that two other shareholders were not misled by defendant's omissions, have nothing to do with the distinction between omissions which "might" have been considered important and those which "would" have been considered important as discussed in Gerstle. In making such comments, defendant is apparently attempting to show that its omission did not make the proxy material misleading. However, as shown on pages 19 through 21 hereinabove, the omission clearly made the proxy statement misleading. Moreover, as shown on pages 28 through 29 herein, evidence as to what two other dissenting shareholders did is meaningless. In any event, no testimony on the subject was introduced at the trial, and, since no reason was shown for failing to do so, the court properly denied defendant's motion to reopen the trial. 6A Moore's Federal Practice, ¶59.07, ¶59.08[3] at pp. 59-115 through 59-117 (2d Ed. 1974); Everest v. Buffalo Lubricating Oil Co., 22 F. Rep. 252 (N.D.N.Y. 1884); Heikkila v. Barber, 164 F. Supp. 587, 592 (N.D. Cal. 1958).

3. Section 14(a) Protects Against Misrepresentations In Proxy Material, With Respect To The Procedure For Obtaining Appraisal Rights, To The Same Extent As It Protects Against Misrepresentations Pertaining To The Company and/or Its Management.

Defendant has made the novel argument that the proxy rules do not protect against an omission in proxy material relating to the statutory procedure to be followed for exercising appraisal rights, but only giving rise to an action in the event of a material omission relating to the company and its management.

This contention flies in face of the language of Item 2 of Schedule 14(a) under Regulation 14A, which expressly requires proxy materials to "indicate any statutory procedure required to be followed by dissenting security holders in order to perfect [rights] of appraisal", and Section 14(a) of the Act which authorizes the SEC to promulgate rules and regulations "for the protection of investors". The SEC has promulgated a rule "for the protection of investors" requiring a company to disclose the statutory procedure required to exercise appraisal rights. Defendant's contention that the Act is not intended to provide such protection is without any basis whatsoever.

In support of defendant's unique contention, defendant cites, out of context, a statement in SEC v. Texas-Gulf Sulfur Co., 401 F. 2d 833 at 849 (2nd Cir. 1968) that material facts include information disclosing the earnings and distributions of the company and facts affecting the probable future of the company which may affect the desire of the investor "to buy, sell or hold company securities". What the defendant did not state was that the court was considering material facts with respect to Rule 10b-5 violations, and not violations under the proxy rules involved in the instant action. Indeed, in the very next sentence, the court explained that its statement as to what a material fact includes pertains to a Rule 10b-5 violation, and particularly to a failure to disclose inside information, as follows:

"In each case, then, whether facts are material within Rule 10b-5 when the facts relate to a particular event and are undisclosed by those persons who are knowledgeable thereof will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of company activity." (401 F 2d at 849) (Emphasis added)

Moreover, in SEC v. Texas-Gulf Sulfur, the court did not state that material facts include exclusively the itemization mentioned therein and, therefore, the case does not support in any way the argument made by the defendant.

4. Plaintiffs Were Not Contributorily Negligent And, Even If They Had Been, Contributory Negligence Would Not Be A Defense To Defendant's Violation Of The Act.

Defendant contends that two other dissenting beneficial owners of its stock objected through the registered owners; that this shows that the plaintiffs were contributorily negligent in not properly objecting; and that as a result defendant is not liable for its violation of the proxy rules. There are a myriad of reasons why this contention is without merit.

(a) The Evidence Clearly Supports The Finding By The Court Below That The Plaintiffs Acted With Care And Were Not In Any Way Negligent.

Anreder testified at the trial that he attempted to follow the instructions contained in the proxy statement, "step by step" in preparing the letter of objection to the recapitalization (77a). This testimony is uncontroverted and precludes any finding that the objection was made by the beneficial owner, rather than the registered owner, because of a haphazard or careless reading of the proxy material.

The evidence that two other dissenting beneficial shareholders properly objected has no bearing on whether or not the plaintiffs were negligent. A statistic based upon only three shareholders has no significance. Moreover, a statistic that 33-1/3% of all those who relied upon the proxy statement were misled,

is at least as indicative of a conclusion that reasonable shareholders exercising due care were misled as it is of a conclusion that such shareholders were not misled.

(b) The Trial Court's Factual Finding That Plaintiffs Acted Without Contributory Negligence Should Not Be Disturbed By This Court Because Such Finding Was Not "Clearly Erroneous".

Rule 52(a) of the Federal Rules of Civil Procedure states, in part:

> "Findings of Fact shall not be aside unless clearly erroneous and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses." (Emphasis Added)

In the instant action, the trial court has found, as a fact, that the plaintiff "exercised reasonable care and was not guilty of contributory negligence." (313a). In view of Anreder's uncontroverted testimony that he read the instructions for exercising appraisal rights provided in the proxy statement, and attempted to follow them on a "step-by-step basis", it cannot be said that the court's factual finding, that reasonable care was exercised by plaintiffs, is "clearly erroneous".

(c) The Evidence Submitted That Two Other Dissenting Shareholders Properly Exercised Their Appraisal Rights Was Not Provided At Trial And, Therefore, Should Not Be Considered.

The only evidence that the two other dissenting shareholders properly exercised their appraisal rights is contained in affidavits submitted after the trial upon the Reargument Motion. Therefore, such evidence is part of this record only for the purpose of reviewing the propriety of the trial court's refusal to reopen the trial. Since the defendant offered no excuse for not providing testimony at the trial on this subject and since, as previously indicated, such evidence, if introduced, would have been without significance, the court properly denied the application to reopen the trial.

(d) Defendant's Liability Arises From A Violation Of A Federal Statute And, Unlike Liability Based Upon Common Law Negligence, No Defense Of Contributory Negligence Exists With Respect Thereto.

The defense of contributory negligence, available in some states to a claim of common law negligence, is completely inapplicable to liability arising, as in the instant action, from a violation of a federal statute. The references in Gerstle; Gould v. American Hawaiian Steamship Company, 351 F. Supp. 853 (D. Del. 1972) and other cases to negligence in connection with proxy rule violations, do not signify that the plaintiffs' claim is based upon common law negligence. Indeed, such a contention would obliterate the need for a cause of action under the Act. Those cases merely state that in some instances the defendant must have acted with a degree of culpability tantamount to negligence for liability under the Act. They make no reference to the degree of care required to be exercised by the plaintiff. See for example, Gould, at pages 858-859, where the court discusses reason for the negligence requirement strictly in terms of the practical necessity of relieving guiltless defendants from liability, without reference to any duty of care imposed upon a plaintiff.

The inapplicability of contributory negligence, as a defense to a violation of the Federal Proxy Rules, is further illustrated by a realization that the common law defense varies from state to state. In some states, contributory negligence is a complete defense to a claim of common law negligence, while in others only the partial defense of comparative negligence exists. If plaintiff's negligence were an issue in this case, would the law of states relating to contributory or comparative negligence apply? The obvious answer is that all such state law is inapplicable since it is not common law negligence which is involved, but the violation of a federal statute and federal substantive law. The only federal substantive law

on this matter enunciated in the cases is that, under circumstances different from those which exist in this case, a defendant must act with a <u>culpability</u> reaching the level of negligence. There is no federal law to the effect that negligence on the part of the plaintiff is any defense.

(e) The Reference In The <u>Gerstle</u> And <u>Gould</u> Cases To A Negligence Level Of Culpability Is Not Applicable To The Instant Action Where The Violation Involved Is Of An Explicit, Well Defined, Statutory Duty Designed For The Protection Of A Specific Class Of Persons.

The reference to negligence in <u>Gerstle</u>, <u>Gould</u> and other cases is entirely irrelevant where, as in the instant action, the violation involves the breach of a specific statutory duty imposed by Congress for the protection of a specific class of persons, i.e., dissenting shareholders.

In <u>Lewis</u> v. <u>Dansker</u>, CCH Fed. Sec. L. Rep. ¶93,916 (S.D.N.Y. 1973), a violation of a specific statutory duty, i.e, Item 11a of Schedule 14A under Rule 14(a)-3, was involved, in the same manner as a violation of the specific statutory duty set forth in Item 2 of the same schedule is involved in the instant action. The court held that the defendant was absolutely liable for its violation of the specific duty and granted summary judgment to the plaintiff, without regard to the presence or absence of negligence, even though the violation may have resulted from an oversight by its attorneys. The court stated:

> "In any event, it hardly needs saying that oversights on the part of attorneys constitute no defense to §14(a) violations. Were it otherwise, of course, the Congressional mandated policy of full and <u>strict compliance</u> with the disclosure requirements of §14(a) could be substantially thwarted." (Emphasis Added) (At Page 93,667.)

The cases relied upon by the defendant, which state that the defendants therein had to have been culpable of at least negligence in mak-

ing their misrepresentations, deal with the disclosure of broad, general information about the company and its officers, rather than with a specific mandated statutory duty, as in Lewis and the case at bar. Thus, those cases do not stand for the proposition that negligence is required in the instant action.

A negligence standard for liability with respect to the violation of specifically defined duty under the proxy rules, such as the duty imposed by Item 2 of Schedule A, makes no sense because such a violation necessarily constitutes negligence, i.e., negligence, *per se*. In the leading cases of Tedla v. Elman, 280 N.Y. 124 (1939) and Schmidt v. Merchants Dispatch Transit Co., 270 N.Y. 287 (1936), the New York State Court of Appeals explained this doctrine of law as follows:

> "The duty imposed by statute is absolute and proof of disregard of a duty created by statute for the protection of a special class establishes, it has been said, negligence as a matter of law." Schmidt, *supra* at 305.
>
> "Negligence is failure to exercise the care required by law. Where a statute defines the standard of care and the safeguards required to meet a recognized danger, then, as we have said, no other measure may be applied in determining whether a person has carried out the duty of care imposed by law. Failure to observe the standard imposed by statute is negligence, as a matter of law." Tedla, *supra* at 131.

POINT II

THE FINDINGS OF THE COURT BELOW, WITH RESPECT TO THE AMOUNT OF DAMAGES INCURRED BY REASON OF DEFENDANT'S VIOLATION, SHOULD BE AFFIRMED.

A. The Factual Finding Made By The Court Below, As To The Value Of The Prior Preferred Stock, Is Largely Discretionary And Should Not Be Disturbed Upon Appeal Unless Absolutely Baseless.

As stated in Rule 52 of the Federal Rules of Civil Procedure, no finding of fact by the trial court shall be set aside upon appeal "unless clearly

erroneous and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses".

A trial court's factual findings as to the value of securities should be even less subject to being set aside than findings of fact in general, because valuation is primarily subjective and not amendable to any definitive objective test. While there can be only one correct factual finding with respect to the occurrence of specific events, there is no one specific value of securities which is absolutely correct to the exclusion of different values which may be reached by others. Thus, the valuation of securities by a trial court should not be set aside merely because an appellate court concludes that it would have placed a different value on them. A trial court's findings as to valuation should be given even greater weight where, as in the instant action, the appellant had sought and obtained the right to reargue the issue and the trial court had given detailed additional consideration to the issue.

This concept was discussed and adhered to by the New York State Court of Appeals in Matter of Endicott Johnson Corp. v. Bade, 37 N.Y. 2d 585, with respect to appellate review of a trial court's appraisal of securities under Section 623 of the New York Business Corporation Law, a statute very similar to the Pennsylvania Appraisal Statute involved in the instant action. In Endicott Johnson, the court stated:

> "The ultimate valuation to the extent that it is confined to the issues of fact, rests largely within the discretion of the lower courts (Cohen & Karger, Powers of the New York Court of Appeals, §148 pp. 589-590), to whose review the appraiser's findings are subject. (Amella v. Consolidated Edison Co. of N.Y., 73 N.Y.S. 2d 263, aff'd 273 App. Div. 755) As we said in Matter of Fulton (257 N.Y. 487, 494), 'No rule can be layed down for determining the actual or true value of stock of a given class except one of a very general nature and which may,

in a particular case, be inapplicable...because of the existence of a state of facts peculiar to the situation involved in the particular case.'" (37 N.Y. 2d 585 at 588) (Emphasis Added)

The recognition by the New York Court of Appeals, that valuation of stock in appraisal proceedings must be the province of the trial court and is largely discretionary, is clearly applicable in the instant action. Indeed, even though appellate courts in New York State are expressly authorized and directed to review questions of fact as well as law (CPLR 5501(c)), the court in Endicott Johnson held that factual findings as to value of securities should rarely if ever be set aside. In the instant action, where the more restrictive review of factual issues set forth in Rule 52 of the Federal Rules of Civil Procedure is applicable, i.e., where factual findings must be "clearly erroneous" to be set aside, the lower court's valuation determination should not be disturbed.

B. The Court Below Did Not Improperly Value The Preferred Stock By Disregarding Net Asset Value And Market Value, And Basing Its Decision Wholly On Investment Value.

Defendant states that In Re Watt & Shand, 452 Pa. 287, 304 A. 2d 694 and other Pennsylvania cases, require an appraisal to be made by weighing three factors, i.e., (i) net asset value; (ii) actual market value; and (iii) investment value. It argues, however, that the court below did not comply with this requirement because "it chose to disregard entirely the first two methods and rely solely upon investment value". (See Appellant's Brief, p. 23). However, the defendant has completely misunderstood the intention of the Pennsylvania Courts and the generally recognized manner in which the three criteria are to be applied.

A reading of Watt & Shand shows that the court therein did not purport to set forth a rigid procedure for determining valuation when it categorized the three commonly

considered critera, but set forth guidelines to be applied as the appraiser determines appropriate under the circumstances of each particular case. The court in Watt & Shand supra, made it clear that the three guideline facts included a consideration of various components, which, from a reading of its decision, were considered by the trial court herein. The court, in Watt & Shand stated:

> "'some of the factors that must be considered in rendering an intelligent decision are: asset value; market value; market prices of comparable companies; market price and earnings ratio; management and its policy, earnings; dividends; valuation of assets; reserves for various contingencies; tax liability; future earnings; prediction of future business events and etc. The list seems interminable and yet all factors must be considered and given their proper weight in order that a just result may be obtained.'" Watt & Shand, 304 A 2d at p. 698, quoting Austin v. City Stores (no. L) 89 Pa. D&C 57 at p. 59. (Emphasis Added)

Other Pennsylvania Courts have also stated that, in evaluating securities, each case must be considered on its own and that no mathematical formula can or must be rigidly applied

> "...the ultimate determination of fair value is a matter of judgment based upon consideration of all of the factors present in a particular case. No mathematical formula can be devised which will bring a fair result in every case, and each case must be considered on its particular facts. Factors which are important in one case may be unimportant in another, and vice versa." Sanders v. Steinwehr Development Co., 5 Adam L.J. 69 (1964)

> "Every relevant fact and circumstance which enters into the value of corporate property, and which reflects itself in the worth of corporate stock, must be considered." [Quoting from 13 Fletcher, Cyclopedia Corporation (Perm. Ed.) 256 ¶5899] Dunddy v. Conshohocken Printing Co., 67 Mong. Co. L.R. 267, 268 (1951), aff'd 171 Penn. Supra 140 (1952).

In the instant action, the trial court, in accordance with the procedure set forth in the Pennsylvania cases, took into account the many and varied factors involved in evaluating the Preferred Stock of the defendant. It considered the three principal methods of valuation and, in weighing the relative

importance of each in the particular case before it, found that the value testified to by the plaintiffs' expert was reasonable.

The trial court took into account, inter alia, that unlike the situation involved in Watt & Shand, involving common stock, preferred stock was involved in the instant action. In valuing preferred stock, net asset value and market value have significance only insofar as they bear upon the question of the likelihood of whether the cumulative dividends will be paid and whether liquidation preferences would be meaningful. The value of common stock, as in the Watt & Shand matter, is far more dependent upon asset value because a common stockholder has a direct proportional interest in the net assets of the company. A preferred shareholder is limited to and primarily interested in his preference rights, i.e., cumulative dividends and liquidation rights. He is closer to a debenture holder who also has no proportional interest in the company's assets.

The market value of preferred stock also often distorts its true value because, as Mr. Anreder testified, the public does not generally understand senior securities. Thus, the court did not disregard net asset value, and market value of the Preferred Stock, but considered those factors along with the circumstances peculiar to this case in determining the relative weight to be given each.

In the matter of Endicott Johnson v. Bade, supra, the New York Court of Appeals discussed the three methods of valuation and held it proper to apply them in precisely the manner applied by the trial court herein. The New York court stated:

> "It follows that all three elements [net asset value, market value and investment value] do not have to influence the result in every valuation proceeding. It sufficies if they are all considered...

The three elements are not always discreet; definitionally, they may even flow into one another. For instance, in this very case, by their general concurrence that it would here be inappropriate, no estimation of net asset value is attempted by the parties or the appraiser. Since the corporation was not being liquidated, but was to continue to operate as part of the surviving parent, McDonough Corporation, that made business and legal sense. For, in cases of non-liquidation, to the extent that net asset value might include elements such as good will and potential earnings, these are invariably taken into account, in any event, among the numerous tangible and intangible factors that enter into judgment of the investment value of going concerns, whether by experienced appraisers or prudent investors. [citations]

Indeed, in this case, investment value, for all practical purposes, became the sole determinate of fair value when the appraiser eliminated market value as a meaningful factor by reporting as follows:

> 'My opinion is that little weight should be given to the past history of market value prior to 1969 because I believe that there was a radical enough change in the management of the company so that it had 'turned around', and that the pre-1969 market is not particularly helpful.'" 37 N.Y. 2d 585 at 588-589 (Emphasis Added)

The similarity between the circumstances in the Endicott Johnson case and the instant action is striking. As in Endicott Johnson, the trial court herein considered net asset value, market value and investment value but had compelling reasons for not giving net asset value and market value as much weight as certain parties to the litigation desired. In Endicott Johnson as in the instant action, the corporation was not being liquidated so that net asset value is included in various elements that are "invariably taken into account, in any event" by the appraisers. In Endicott Johnson, as in the instant action, "there was a radical...change in the management of the company so that it had 'turned around'", so that the value of the securities were more than might be indicated by the financial status of the company resulting from its prior activities. In short, as required under the Pennsylvania cases, and as clarified by the New York Court of Appeals in Endicott Johnson, the trial court below considered the three

principal methods and utilized them properly, along with all the other pertinent factors to be considered, and arrived at a proper valuation.

C. Contrary To Defendant's Contention, It Was Not The Court Nor The Plaintiffs' Expert Who Failed To Value The Preferred Stock On A "Going Concern Basis", But It Was The Defendant's Expert Who Erroneously Concluded That The Company Would Not Be Able To Continue Operations Without A Recapitalization.

The defendant makes the surprising contention that the court did not value the Preferred Stock on the basis of the company as an ongoing concern as required under Watt & Shand, supra, but upon the basis of a liquidation of the company. Apparently, defendant raises this argument because in testing the accuracy of Mr. Anreder's evaluation, the court considered the redemption price and accrued dividends which could be payable to preferred holders in 1986.

The court did not, however, value the Preferred Stock upon its consideration of payments which might be made to them in 1986. As stated by the court in its supplemental findings:

> "This court, in computing the damages suffered by plaintiff, applied the per share valuation figure suggested by plaintiff's expert. The court found the opinion of plaintiff's expert to be supported by the evidence, and the considerations and implications flowing therefrom." (314 - 315a)

As the court went on to say, it considered the possibility of the payments to Preferred Stockholders in 1986 only after it had determined damages based upon the testimony of plaintiffs' expert, and only as a further test of the reasonableness of such testimony (315a). Since the court did not utilize its consideration of the possible payments in 1986 as the basis for its valuation, but only as a comparison to the expert testimony upon which it did base its valuation, defendant's contention is without merit.

Defendant's contention is also without merit because it misunderstands what the Watt & Shand court meant when it required that valuations be based on "going concerns". The court in Watt & Shand simply meant that a dissenting shareholder is entitled to more than he would obtain if the company liquidated at the valuation day. He is also entitled to share in the company's future returns. Thus, a consideration of a security's liquidation rights, realizable at some distant time in the future, is certainly not precluded. Indeed, such a consideration necessarily implies, as held by the trial court herein, that on the valuation day the company is indeed a "going concern".

When the court in Watt & Shand stated that valuation must be on a "going concern" basis, it cited and quoted from a California Law Review Note as follows:

> "'Essentially what is being valued is a right to share the future returns of a going concern'"(304 A 2d at 698, f.n. 5) (Emphasis Added)

Clearly, the trial court's examination herein of possible payments to the Preferred Stockholders in 1986, i.e., 14 years after the valuation day, is an examination of their "right to share the future returns" and, thus, is based upon a "going concern" within the meaning of Watt & Shand.

Unlike the court and the plaintiffs' expert, which properly based their evaluation on the company continuing in business, the defendant's expert based his opinion upon an erroenous contention that the company's business would not continue.

D. The Trial Court Properly Weighed the Evidence In Reaching Its Finding of Value.

As shown on pages 32 through 34 above, the trial court's finding as to value is largely discretionary and should not be set aside unless clearly erroneous.

In view of the false premises upon which the valuation by defendant's expert was based and his complete failure to take into account the "turn around" of the company resulting from its new management, when contrasted to the careful consideration of all pertinent factors utilized by plaintiffs' expert in reaching his valuation (see pages 8 through 17 above), how can it be said that the trial court did not use sound discretion, or was clearly erroneous, by deciding in accordance with plaintiffs' expert after weighing his testimony against that of the defendant's. Indeed, if the trial court had instead accepted Mr. Shinegal's testimony, and rejected Mr. Anreder's , its findings would have been subject to reversal.

E. Defendant's Contention That The Court's Valuation Was In Error Because The Principal Amount Of The Debentures Must Be Paid Before Dividends On The Preferred Stock Are Distributed, Is Without Merit.

The defendant has argued that consideration of the dividends and redemption price payable to the Preferred Stockholders in 1986 is meaningless because, after the debentures are paid at that time, there will be nothing left with which to pay the dividends on the Preferred Stock.

Firstly, as shown on page 38 above, the court did not base its findings on any such consideration as to what the Preferred Stockholders would receive in 1986, but on Mr. Anreder's testimony. Secondly, the defendant's argument is also false because in 1986 there would be no need to redeem the Preferred Stock and pay all of the dividend arrearages. If there were sufficient money to pay off the debentures, the company would have no prior debt and the Preferred Stock would be the company's senior security entitled to payment in full of all dividend arrearages before any dividends could be paid on the common stock. The value of the Preferred Stock would thus be substantial, without payment of

dividends at that time, and the court was perfectly correct in examining the possibility of it obtaining such value in 1986. In stating that the company must pay an additional $45,070,000 to pay the accrued dividends on the Preferred Stock in full, the defendant is merely setting forth a scare figure based on the falacious premise that the Preferred Stock dividends must be paid in full in 1986.

The defendant argues that the company would require an annual cash flow of $4,395,000 in order to pay the dividends on the Preferred Stock in 1986. Such a cash flow, however, is based upon the false premise that the $45,070,000 in accrued dividends must be paid to the Preferred Shareholders before the Preferred Stock of that value. It would take a cash flow of only a fraction of that figure, however, between 1972 and 1986, to pay the debentures and thereby make the Preferred Stock the senior security of the company. Given the defendant's turn around in 1972, and the fact that there would be 14 years to earn that money, it is totally within reason to arrive at the opinion that defendant, as a going concern, could make enough money to either pay off its debentures or eliminate them through refinancing, tenders or open market purchases prior to 1986. Since the company had exhibited such a turn around by again starting to earn money in 1972, it had significant flexibility in dealing with its income debentures prior to their 1986 date.

Finally, once the company achieved the economic turn around indicated by the evidence, it would become profitable and have significant flexibility to deal with the payment of both the debentures and Preferred Stock by 1986 through refinancings, new borrowings and capital generating activities. To argue as does defendant, that the company cannot possibly do so, under these circumstances, is completely without basis.

F. Defendant's Contention That There Was Insufficient Evidence To Find That The Company Would Not Go Bankrupt Before 1986 Is Erroneous.

Defendant contends that the company would have gone bankrupt, precluding payment of dividends on the Preferred Stock, and states that the record provides no evidence to the contrary. This is patently false.

Not only did Mr. Anreder's testimony clearly evidence that defendant could "continue operating the company", not only did Mr. Ser Vaas himself state that the company could continue in business "indefinitely", and not only did the defendant's expert finally admit that the company was not in danger of bankruptcy (232a - 233a), but an examination of the balance sheet also reveals that the company was in no danger whatsoever of bankruptcy or liquidation.

The March 31, 1972 balance sheet shows that of the company's $16,000,000 in liabilities, $13,000,000 thereof consisted of items that were not payable until October 1, 1986 or not payable at all under any circumstances. For example, $2,500,000 of liabilities consisted of contingent interest on the debentures which is not unconditionally payable until October 1, 1986; $7,500,000 consisted of principal due on the debentures which is not payable until October 1, 1986; and $3,000,000 consisted of subscription items, the latter being a bookkeeping item, not a cash item which is reduced as magazines are published.

The trial court was not taken in by financial arguments based upon the bald figure of $16,000,000 in liabilities, but recognized that, until October 1, 1986, the companycould continue to operate without having to meet any significant cash demands of creditors, that such liabilities had no effect on defendant's ability to earn money and that, given defendant's economic revival, with its previous operating losses able to protect it from paying income taxes, a very different picture appeared than the one which Mr. Shinagel attempted to

paint at the trial. The picture is even brighter for the company when one considers the fact that on the asset side of the balance sheet (showing approximately $3,000,000 in assets), no consideration was given to company's rights in the Timmins Mine property, which was valued by the company's own appraisers at between $2,000,000 and $6.5 million.

CONCLUSION

THE JUDGMENT OF THE LOWER COURT SHOULD BE AFFIRMED IN ALL RESPECTS.

Respectfully submitted,

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the within brief is

hereby admitted this 26 day

of January, 1976

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Attorney for